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IN THE

Supreme Court of the United States

October Term, 1936

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

H. C. GOWRAN.

AMICUS CURIAE BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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v.

H. C. GOWRAN.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

MOTION FOR LEAVE TO FILE A BRIEF AS *AMICUS CURIAE* IN OPPOSITION.

Now comes Roger S. Baldwin, attorney and counsellor of this Court, and represents that there are involved in this case questions which vitally affect the interests of four of his clients, who are now in controversy with the Treasury Department as to whether or not certain stock dividends received by them are subject to income tax; and, if not so subject to income tax, as to what is the cost basis of the dividend stock and whether Section 115 (g) of the Revenue Act applies to the sale of such stock dividends to the cor-

poration which paid them. The final decision in this case may determine the question of the tax liability of such four Taxpayers.

The Solicitor General, on behalf of the Petitioner, and the attorney for the Respondent Taxpayer have consented to the filing by the undersigned of an *Amicus Curiae* brief herein.

Therefore, he prays leave as *Amicus Curiae* to file the brief submitted herewith in opposition to the Petition for a Writ of Certiorari herein.

BRIEF *AMICUS CURIAE.*

Opinions Below.

The opinion of the Board of Tax Appeals (R. 39) is reported in 32 B. T. A. 820; the opinion of the Circuit Court of Appeals for the Seventh Circuit is reported in 87 Fed. (2d) 125.

Questions Presented.

I. Is a dividend by a corporation in its own Preferred Stock, paid to holders of Common Stock when there were other shares of Preferred Stock of the same classification outstanding a part of which were held by others than the common stockholders, a "stock dividend" within the meaning of Section 115 (f) of the Revenue Act of 1928?

II. Is such a Preferred Stock Dividend taxable under the Sixteenth Amendment to the Constitution?

III. What is the correct cost basis of a Preferred Stock Dividend paid on Common Stock, assuming that such dividend was not subject to tax under the Statute at the time of its receipt?

IV. Whether this case should be remanded to the Board of Tax Appeals for determination with respect to the applicability of Section 115 (g), relating to the redemption of stock under such circumstances that it should be treated as equivalent to the distribution of a taxable dividend?

Statutes Involved.

The Statutes involved are contained in the Appendix.

Statement.

This controversy arises out of a proposed deficiency in Federal income tax of the Responding Taxpayer for the year 1929.

On June 29, 1929, the Hamilton Manufacturing Company, a Wisconsin corporation, declared a dividend on all of its outstanding common stock to the holders thereof of record on July 1, 1929. The dividend amounted to $14 per share, payable in non-voting preferred stock of the Company (R. 13, 42).

Prior to July 1, 1929, there were outstanding 7,155 shares of preferred stock of the Company, held by approximately 300 individual stockholders, none of which was held by the Taxpayer.

On July 1, 1929, there was common stock of the Company outstanding amounting to 18,680.08 shares held by 30 individuals.

On July 1, 1929, the Company's earned surplus available for distribution was not less than $444,147.05. There then remained unissued $261,600 par value preferred stock available for issue by way of stock dividend. The amount of such stock called for by the dividend of July 1, 1929 was $261,531.20 (R. 42).

The Taxpayer received as his share of the preferred stock dividend declared on July 1, 1929, 533.715 preferred shares (R. 16, 42). The preferred stock so received by the Taxpayer had a fair market value of $100 per share when received (R. 43).

On or about October 1, 1929, the Taxpayer sold all of the preferred stock so received by him as a dividend to the Hamilton Manufacturing Company, such sale being at par, *i. e.*, $100 a share (R. 43).

The Board of Tax Appeals originally decided that the sale by the Taxpayer of the preferred stock received by him as a dividend was not made under such circumstances as to make the transaction equivalent to the distribution of a taxable dividend (R. 18-28). In a later opinion the Board held that the stock dividend in question, paid in preferred stock to holders of common stock, was not a tax free stock dividend (R. 39).

The Taxpayer appealed to the Court below which decided that the stock dividend in question, while constituting income under the Sixteenth Amendment, was not subject to tax under Section 115 (f) of the Revenue Act of 1928. With respect to the cost basis of the dividend stock, the Court decided that it was the value of the stock at the time the Taxpayer received the stock dividend and not zero, as contended by the Government.

Reason for Not Granting the Writ.

The questions presented do not warrant further consideration by this Court.

Argument on Questions Presented.

I.

Is a dividend by a corporation in its own Preferred Stock, paid to holders of Common Stock when there were other shares of Preferred Stock of the same classification outstanding a part of which were held by others than the common stockholders, a "stock dividend" within the meaning of Section 115 (f) of the Revenue Act of 1928?

Section 115 (f) of the Revenue Act of 1928 provides:

"A stock dividend shall not be subject to tax."

The question here presented involves the construction of the above quoted Section. It was determined in the negative and in favor of the taxpayers by the Circuit Court of Appeals for the Seventh Circuit in this case, decided December 22, 1936, and by the Circuit Court of Appeals for the Second Circuit in the case of *Pfeiffer* v. *Commissioner,* decided February 15, 1937 (88 Fed. (2) 3) in which we are attorney of record. In the latter case, a Petition for a Writ of Certiorari to this Court was also filed by the Government on April 15, 1937. It is assumed that such Petition will be considered at the same time as the Petition in this case.

As we will file a brief in opposition to the Petition for a Writ of Certiorari in the *Pfeiffer* case, in which we will discuss this question, we refrain from discussing it here at length. We respectfully refer the Court to our brief filed in the *Pfeiffer* case, so far as such question is concerned.

It might, however, be here stated that there has been no conflict in the Circuit Courts of Appeals on this question, in any case where the Government was attempting to tax stock dividends as income, and certainly not since the decision of the Supreme Court in the case of *Koshland* v. *Helvering,* 298 U. S. 441, in which this Court refrained from deciding such question, but clearly seemed to indicate its opinion that all stock dividends, meaning those paid in stock of the paying corporation, are exempt from taxation under the applicable Statutes.

These decisions on this question conform to an apparent Legislative and Administrative policy of so many years' standing that there is no reason why this Court should be asked to review or change it.

The Government itself, before the Board of Tax Appeals, the Circuit Courts of Appeals, and this Court, uniformly and continuously has maintained and argued (ex-

cept in these two most recent cases of *Gowran* and *Pfeiffer*) that stock dividends under the Statute were *not* subject to taxation. There is nothing in the *Koshland* decision requiring a reversal of position by the Government, or the infliction of such tremendous hardships upon taxpayers as would result from the reversal of its long established administrative policy, upon which taxpayers have relied, and according to which taxpayers have shaped their corporate financial policies for fourteen years.

There is no Constitutional question involved in this question.

II.

Is such a Preferred Stock Dividend Taxable under the Sixteenth Amendment to the Constitution?

The Circuit Court of Appeals for the Seventh Circuit apparently assumed that, by reason of the decision of the Supreme Court in the *Koshland* case, the stock dividend here under discussion must be held to be income which Congress, under the Constitution, might tax.

If this Court agrees with the Circuit Court of Appeals that a stock dividend is not taxable as income under the Statutes, the taxability of such income under the Constitution need not be decided here, at least so far as concerns the taxability of the stock dividend distribution. If, however, this Court should not agree with the Circuit Court of Appeals that a stock dividend is not taxable under the Statute, then the question of taxability under the Constitution would be an issue and should be argued before this Court.

A dividend of Prefetred Stock on Common Stock, such as was paid in this case, presents a very different situation

from that which existed in the *Koshland* case, where there was a dividend of Common Stock paid upon Preferred Stock. It would not seem, however, that this question should be argued on this application

III.

What is the correct cost basis of a Preferred Stock Dividend paid on Common Stock, assuming that such dividend was not subject to tax under the statute at the time of its receipt?

This is the main question toward which this brief is directed.

1. The Government maintains in its brief, as an alternative argument, that, if the Preferred Stock in question was not subject to tax under the Statute at the time of its receipt, such stock had a basis of *zero* for determining gain or loss from the sale or other disposition thereof, with the result that the entire proceeds from the sale would constitute taxable gain. The Government maintains that the decision of the Supreme Court in the *Koshland* case supports such conclusion. We find nothing in the *Koshland* case to that effect.

This Court in the *Koshland* case, as we read its opinion, held that the statutory basis of the stock *on which the dividend was paid* was its actual "cost" and that the Treasury Regulations requiring the apportionment of this "cost" between the old and the new stock were invalid, because of the express provisions of the Statute to the effect that the basis shall be cost.

As we read such opinion, a taxpayer who has received a *stock dividend which constitutes "income" under the*

Constitution, regardless of whether or not Congress taxed this dividend *at the time of its receipt,* is entitled to take as his basis for the dividend stock its fair market value as of the date of its receipt. This conclusion would seem to follow necessarily from the reasoning of the Court that a stock dividend which has the effect of changing the relative interests of the stockholders represents a segregation of "income" from "capital". This segregation, necessarily, creates a new basis for the stock dividend. Accordingly, if the stock dividend in the case at bar constituted "income" within the meaning of the *Koshland* decision, it follows that, except for the statutory exemption, the dividend would have been taxable as "income" and there can be no doubt but that the amount of "income" would be the fair market value of the dividend stock.

It seems equally clear that in such event, when the stock was sold or redeemed, its statutory basis was not *zero,* but its fair market value when received.

Under the *Koshland* decision, the situation is analogous, if not identical, to that in which a corporation distributes dividends in the form of property. In such a case, the taxpayer is entitled to take as his statutory basis the fair market value of the subject of the dividend (*Edwin D. Metcalf,* 13 B. T. A. 236, aff'd. 32 Fed. (2d) 192; *Daisy M. Ward,* 29 B. T. A. 1251; *Ramapo, Inc.* v. *Commissioner,* 84 Fed. (2d) 986). The shares of stock which were sold or redeemed in this case had not been purchased by the Taxpayer, but had been received by him as a stock dividend and, therefore, did not have a "cost", as the term "cost" is conventionally used. Having no "cost", the Statute providing that "cost" shall be the basis does not apply and a different rule to determine their basis must be used.

It has been uniformly held by this Court, the Circuit Courts of Appeals and the Board of Tax Appeals that where property does not have a "cost", in the conventional sense, and the applicable Revenue Act does not prescribe otherwise, its basis is the fair market value of the property at the time of acquisition by the taxpayer. (*Heiner* v. *Tindle*, 276 U. S. 582; *Rice* v. *Eisner*, 16 Fed. (2d) 358, Cert. Den. 273 U. S. 764; *Helvering* v. *Salvage*, 297 U. S. 106; *Lucas* v. *Daniel*, 45 Fed. (2d) 58; *Bankers Trust Company*, 24 B. T. A. 10; *Francis Francis*, 15 B. T. A. 1332). The fact that no tax was paid upon the receipt of the property is immaterial. (*Helvering* v. *Salvage, supra*).

If the dividend stock received by the Taxpayer in this case constituted "income" when received, then under the cases cited above it is clear that the cost basis of such dividend stock is its fair market value when received and not zero as claimed by the Government.

If, on the other hand, the stock dividend did not result in the distribution or receipt of "income" within the meaning of the Sixteenth Amendment, but resulted in a mere split-up of the shares representing the capital investment, then neither in the *Koshland* case nor in any other Court or Board Decision has there been any doubt cast upon the propriety or validity of the Regulations requiring an adjustment of the cost between the original shares and the new shares issued as a stock dividend.

As an instance where the basis of property received as a dividend is its fair market value at the date of receipt, although the dividend is not taxable, take the case of a distribution out of earnings and profits accumulated prior to February 28, 1913 (Section 115 (a), Revenue Act of 1928). Another instance of this character would be where a domestic dividend is received by a corporate shareholder (Sec. 23 (p) (1), Revenue Act of 1928).

It would be interesting to apply the reasoning in the *Koshland* case to a Stock Dividend, constituting income under the Sixteenth Amendment, if such dividend were received by a corporate shareholder. The dividend, being a dividend received by a corporation, would be exempt from income tax. What should be its basis, assuming that it is income within the reasoning of the *Koshland* case? If a basis of zero should be applied, as contended by the Government in this case, to such a stock dividend received by a corporation, then the corporation upon the sale of the Dividend Stock would be required to pay a tax upon the total value of the stock, thus depriving the corporation of the exemption granted by the Statute. On the other hand, if market value is applied to the Dividend Stock as a basis, there would be no tax upon the sale of the Dividend Stock unless it was sold above the price at which it was received. It is not likely that Congress intended that one basis should be applied to a corporate shareholder and another to an individual shareholder.

The Government claims that because the Taxpayer paid nothing upon the receipt of the dividend, it must be assumed that it cost him nothing and that the basis must, therefore, be zero. There is no Statute or Regulation which so provides, and no authority has been cited or is known to support this view.

2. The Government complains of the comparison, made by the Circuit Court of Appeals in its decision, of the stock dividend in this case with tax free gifts, bequests and legacies, stating that for the latter the Statute itself provides that the basis shall be the value at date of acquisition. The Government points out in its brief that in the case of a stock dividend there is no similar Statute. There is *no*

Statute to the effect that zero shall be taken as the basis of stock received as a dividend, and in the absence of such a Statute an assumption should not be made which violates the realities and is contrary to the general policy of the administration of the Income Tax Law as prescribed in the Statute in analogous situations.

Prior to the enactment of the Statute requiring a donee to use his donor's basis for determining gain or loss from the sale of the subject of the gift, the Statute was silent in regard to the basis which the donee was required to use and in such circumstances it was uniformly held that the donee was entitled to use as his basis the fair market value of the subject of the gift at the time of receipt. A specific amendment of the Statute was necessary to require the donee to use a basis other than the fair market value at the time of receipt. Although the Statute expressly provides the basis of property acquired by legacy or bequest, there is no indication in the Statutes, Regulations or Court Decisions that, in the absence of such a Statute, the recipient would be required to take any basis other than the fair market value as of the date of receipt.

Thus, we submit that the decision of the Circuit Court in this case conforms essentially to the principles of law applicable to the basis of property, other than stock dividends, acquired without an actual outlay of money or other consideration. The facts should not be tortured by assuming a basis which does not exist.

In view of the long continued practice of the Treasury Department in requiring apportionment of cost between the original stock and the dividend stock, which practice was supported by definite and specific Regulations, it is fair to assume that Congress considered this to be the established law. This Court in the *Koshland* case held that these Regu-

lations were invalid as applied to a stock which had a "cost," in that they had the effect of reducing cost by the receipt of income, and that in the absence of Statutory authority the Commissioner was without power to make such a Regulation. The acceptance of the zero basis, as urged by the Government, would result in a larger amount of income and a greater tax liability than would result under the Regulations requiring apportionment which this Court condemned in the *Koshland* case.

Congress having failed to tax stock dividends when received, whether as a legislative policy or due to an erroneous understanding of its powers, certainly it is not proper, in the absence of Statutory provisions, for the Treasury Department to tax such dividends when the dividend stock is sold, except in a case where Section 115 (g) applies. That which is "income" in the year in which it is received, cannot be "capital gain" in the year in which it is sold and cannot be taxed except by special Statutory provision.

If the Government is not satisfied with the present applicable Statutes and Regulations, or their interpretation by the Courts, it would seem as though the remedy were by Congressional Act, as was done by Section 115 (f) of the Revenue Act of 1936, with respect to the taxation of stock dividends when received. This changed the previous Revenue Acts and made stock dividends in the future taxable to the extent that they constitute "income" within the meaning of the Sixteenth Amendment to the Constitution.

IV.

Whether this case should be remanded to the Board of Tax Appeals for determination with respect to the applicability of Section 115 (g), relating to the redemption of stock under such circumstances as to make such redemption essentially equivalent to a taxable dividend?

This question, in its initial stage before the Board of Tax Appeals, was largely a question of fact, but the question, as here presented, is largely a question of procedure. These questions will not be discussed in this brief.

It might, however, be briefly stated that no important question of Federal Law is here involved and no question which would be helpful in the decision of other cases because the application of Section 115 (g) is dependent entirely upon the facts of each individual case.

Conclusion.

There is no important question of law here presented which needs further settlement by this Court.

Respectfully submitted,

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New York City, New York.

Dated: April 30th, 1937.

APPENDIX.

Revenue Act of 1928:

Section 115. DISTRIBUTION BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(f) *Stock dividends.*—A stock dividend shall not be subject to tax.

(g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

Section 23 (p) (1):

In computing net income there shall be allowed as deductions:

Dividends received by Corporations.—In the case of a corporation, the amount received as dividends from a domestic corporation, * * *.

Revenue Act of 1936:

Section 115 (f) (1) General Rule.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

PETITION FOR REHEARING

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vs.

H. C. GOWRAN,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR REHEARING.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR REHEARING.

Comes now the above named respondent, H. C. Gowran, and presents this his petition for a rehearing of the above entitled cause, and in support thereof, respectfully shows:

The judgment of this Court was entered on December 6, 1937. The time for filing a petition for rehearing was enlarged until January 10, 1938, by an order of Mr. Justice Brandeis, dated December 28, 1937. This petition for rehearing is directed to that portion of the decision which

holds that the stock dividend received and sold by respondent Gowran had a basis of zero for the purpose of determining gain or loss.

* * * * * *

Because of the predominance of other issues in the case, Section 113 (b) (1) (D) of the 1932 and later Revenue Acts was overlooked and was not brought to the Court's attention. The effect of this Court's "zero basis" ruling, when applied together with Section 113 (b) (1) (D), is to subject Gowran to a capital levy, or if not that, then inevitably to two taxes upon the same income. Serious constitutional questions are thereby presented which have not been considered but which should be considered by this Court.

Section 113 (b) (1) (D) of the 1932, 1934 and 1936 Revenue Acts provides as follows:

> "The adjusted basis for determining gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under Subsection (a), adjusted as hereinafter provided.
>
> "(1) General rule.—Proper adjustment in respect of the property shall in all cases be made— * * *
>
> "(D) In the case of stock * * * for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax-free or were applicable in reduction of basis * * *"

Under Section 113 (b) (1) (D), Gowran, having received a tax-free stock dividend, is required to reduce the basis of his previously held stock by an amount equal to the value of such stock dividend at date of issue.* At the same

* Under the authority granted in the final paragraph of the opinion, Gowran is prepared, if necessary, to establish before the Board that he continued to own, until after the effective date of the 1932 Revenue Act, his original stock upon which the stock dividend was declared, so that he is subject to Section 113 (b) (1) (D). However, as the opinion now stands, it would be futile for Gowran to establish this or any other additional fact before the Board, since the "zero basis" ruling is based entirely upon the single fact that the dividend stock had no cost (in the sense of purchase price), a fact as to which, of course, no contrary showing can possibly be made.

time, his dividend stock is given a basis of zero under the decision in the case at bar. The value of the dividend stock is thus taxed twice: once when Gowran sells the previously held stock and again when he sells the dividend stock. The result is plainly a capital levy, as will appear from the following illustration:

Let us assume that in 1928 Gowran bought one share of common stock for $14.00; that in 1929 he received a stock dividend consisting of one share of preferred stock having a then value of $14.00; and that in 1932 he sold both shares. Under Section 113 (b) (1) (D), the basis of his common share would be reduced by $14.00 (the value of the stock dividend) and his common share would therefore have a basis of zero. Under the decision in the case at bar, his preferred share would also have a basis of zero. As a result, the entire proceeds from the sale of both shares would be taxed as income, and Gowran would never be permitted to recover free of tax his original capital investment of $14.00. The foregoing is obviously a capital levy rather than a tax on income.

It may be thought that Section 113 (b) (1) (D) is unconstitutional under *Koshland* v. *Helvering*, 298 U. S. 441, in which case this Court held that under the 1928 Revenue Act, the basis of previously held stock could not be reduced by reason of the payment of a stock dividend thereon. However, the *Koshland* decision rested in large part, and could have been rested altogether, upon the lack of statutory authority in the 1928 Revenue Act for such reduction of basis. Such statutory authority was supplied in Section 113 (b) (1) (D) of the 1932 and later Revenue Acts, and it appears, therefore, that the *Koshland* case does not apply to sales under the 1932 and later Revenue Acts. It may be

observed further that if the *Koshland* case should be construed as holding that Congress may not constitutionally postpone the taxing of income by means of making an adjustment in the basis of assets owned by the taxpayer, then serious doubt will be cast upon the validity of all of the reorganization provisions of the various Revenue Acts, since in such reorganization provisions Congress has repeatedly made use of an adjustment of basis as the means of postponing the tax upon income presently received.

As stated at the beginning of this petition, the necessary effect of the "zero basis" ruling in the case at bar, when applied together with Section 113 (b) (1) (D), is to subject Gowran to a tax in the nature of a capital levy; for he would pay an income tax on the entire proceeds of the dividend shares when sold, and would then pay another tax on a like amount (although not income within the meaning of the Sixteenth Amendment) on sale of his original shares. The second tax would necessarily result from the reduction of basis. If it should be held that both taxes are income taxes within the meaning of the Constitutional Amendment, then the taxpayer will be subjected to two income taxes on one income. The "zero basis" rule, as announced in this case, thus raises important questions, constitutional and otherwise, which have not been considered but which it is believed the Court will desire to consider before its decision becomes final.

* * * * * *

In connection with the "zero basis" point, the Court's attention was not called to the effect of Section 115 (f) of the 1936 Revenue Act. Under Section 115 (f) of the 1936 Revenue Act, stock dividends of the type involved in the case at bar are taxed when received, to the extent of their then market value. If such stock dividends received under

the 1936 Revenue Act are given a basis of zero, then they will be taxed twice: once when they are received and again when they are sold. Obviously Congress did not intend in the 1936 Revenue Act to impose such double tax, but on the contrary intended that such stock dividends should be given a basis consisting of their market value when received. And yet the basis provisions of the 1936 Revenue Act, in so far as here material, are identical with the basis provisions of the 1928 Revenue Act, which is involved in the case at bar. No conceivable justification can be found for holding that such identical basis provisions allow market value as the basis under the 1936 Revenue Act, while at the same time requiring a "zero basis" under the 1928 Revenue Act. Both Acts must necessarily be construed as authorizing the use of market value as the basis in the circumstances described, since any other construction raises serious constitutional questions.

In like manner, the Court's attention was not directed to the treatment which is accorded under the various Revenue Acts to dividends in property. Such dividends in property are of course taxed when received, to the extent of their then market value. It has been the universal practice on the part of both the Government and taxpayers to treat such dividends in property as having a basis equal to their market value when received. To give such dividends in property a basis of zero would be to tax such dividends twice: once when they are received and again when they are sold. And yet all of the Revenue Acts, including the 1928 Revenue Act, which is involved in the case at bar, are silent as to the basis of dividends in property, just as in the case of stock dividends they are silent as to basis. No justification can be found for holding that the 1928 Revenue Act allows market value to be used as the basis of divi-

dends in property, while at the same time requiring a basis of zero in the case of stock dividends. It is respectfully urged that as to both types of dividends, the 1928 Revenue Act must be construed as authorizing the use of market value as the basis, since any other construction necessarily raises important and difficult questions as to both the intent and the constitutional power of Congress in the premises.

The views just urged are in accordance with the principles announced by this Court in *Hartley* v. *Commissioner*, 295 U. S. 216, and *Heiner* v. *Tindle*, 276 U. S. 582, which cases are discussed at pages 33-36 of Gowran's brief.

* * * * * *

The points stated and argued above were not, it is believed, considered by the Court in making its decision in this case. They were not presented to the Court on the argument, mainly because there appeared to be other matters involved which were of greater importance, upon which both counsel for the Government and counsel for the taxpayer bestowed their principal efforts. The points raised by this petition for rehearing are, however, inherent in the case, and are questions which this Court will ultimately find it necessary to answer. While this petition for rehearing is made for the purpose of relieving respondent Gowran from the hardship created by the "zero basis" theory as applied to him, it is considered proper to mention also the very substantial public interest involved and on that account to urge that the questions presented be answered here and not be postponed for a period of time which must involve much uncertainty and confusion on the part of both the Government and the taxpayers of the country, with a great amount of litigation in the lower courts. The respondent therefore respectfully prays that this petition for

rehearing be granted and that a reargument be ordered so that the matters above referred to may be fully and properly presented to, and considered by, this Court.

Respectfully submitted,

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CERTIFICATE OF COUNSEL.

I, A. L. Nash, counsel for the above named petitioner, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

A. L. NASH,
Counsel for H. C. Gowran.

SUPREME COURT OF THE UNITED STATES.

No. 27.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* H. C. Gowran.	On Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[December 6, 1937.]

Mr. Justice Brandeis delivered the opinion of the Court.

The questions for decision concern the taxation as income of a dividend in preferred stock and the proceeds received on its sale.

On June 29, 1929, the Hamilton Manufacturing Company, a Wisconsin corporation, had outstanding preferred stock of the par value of $100 a share and common stock without par value. On that day the directors declared from the surplus earnings a dividend of $14 a share on the common stock, payable on July 1, 1929, in preferred stock at its par value. Gowran, as owner of common stock, received as his dividend 533 and a fraction shares of the preferred. On or about October 1, 1929, the company acquired his preferred stock and paid him therefor, at $100 a share, $53,371.50. In his income tax return for the year Gowran did not treat this sum as taxable income, but included $27,262.72 as capital net gain on the shares received and sold, computing the gain under Articles 58 and 600 of Regulations 74, then in force. The Commissioner rejected that treatment of the matter; determined that the $53,371.50 received was income taxable under the Revenue Act of 1928, § 115 (g), 45 Stat. 791, 822, as a stock dividend redeemed; and assessed a deficiency of $5,831.67.

The taxpayer sought a redetermination by the Board of Tax Appeals. A division of the Board concluded, upon testimony and stipulated facts, that there had been no cancellation or redemption of the preferred stock so as to make it a taxable dividend under § 115 (g); that the transaction by which the company acquired it constituted a sale. The Commissioner secured a reconsideration of the case. He then contended that, under the rule declared in *Commissioner of Internal Revenue* v. *Tillotson Mfg. Co.*, 76 F. (2d) 189, the stock dividend was taxable, because it had resulted in a change

of Gowran's proportionate interest in the company. That contention was sustained by the Board; and, on that ground, it affirmed the Commissioner's determination of a deficiency. 32 B. T. A. 820.

The taxpayer sought a review by the Circuit Court of Appeals. The Commissioner again urged that the stock dividend was taxable; and then, for the first time, contended that, even if it was not taxable, the determination of the deficiency should be affirmed, because within the tax year the stock had been sold at its par value and, as its cost had been zero, the entire proceeds constituted income. The Court of Appeals recognized that, since the dividends in preferred stock gave to Gowran an interest different in character from that which his common stock represented, it was constitutionally taxable under *Koshland* v. *Helvering,* 298 U. S. 411; but it held that the dividend could not be taxed as income, since by § 115 (f) Congress had provided: "A stock dividend shall not be subject to tax". And it held further that no part of the proceeds could be taxed as income, since there was no profit on the sale, it being agreed that the fair market value of the stock, both at the date of receipt and at the date of the sale, was $100 a share. 87 F. (2d) 125.

Because of the importance of the questions presented in the administration of the revenue laws, certiorari was granted. 301 U. S. —.

First. The Government contends that § 115 (f) should be read as prohibiting taxation only of those stock dividends which the Constitution does not permit to be taxed; and that, since by the dividend Gowran acquired an interest in the corporation essentially different from that theretofore represented by his common stock, the dividend was taxable. In support of that construction of § 115 (f), it is urged that Congress has in income tax legislation manifested generally its intention to use, to the full extent, its constitutional power, *Helvering* v. *Stockholms Bank,* 293 U. S. 84, 89; *Douglas* v. *Willcuts,* 296 U. S. 1, 9; that this Court holds grants of immunity from taxation should always be strictly construed, *Pacific Co.* v. *Johnson,* 285 U. S. 480, 491; and that the only reason for exempting stock dividends was to comply with the Constitution.

This preferred stock had substantially the same attributes as that involved in the *Koshland* case. There the dividend was of common stock to a preferred stockholder, it is true; but we are of opinion that under the rule there declared Congress could have taxed this

stock dividend. Nevertheless, by § 115 (f) it enacted in 1928, as it did in earlier and later Revenue Acts, that "a stock dividend shall not be subject to tax." The prohibition is comprehensive. It is so clearly expressed as to leave no room for construction. It extends to all stock dividends. Such was the construction consistently given to it by the Treasury Department.[1] The purpose of Congress when enacting § 115 (f) may have been merely to comply with the requirement of the Constitution as interpreted in *Eisner* v. *Macomber*, 252 U. S. 189; and the comprehensive language in § 115 (f) may have been adopted in the erroneous belief that under the rule declared in that case no stock dividend could be taxed. But such facts would not justify the Court in departing from the unmistakable command embodied in the statute. Congress declared that the preferred stock should not be taxed as a dividend.

Second. The Government contends that, even if § 115 (f) be construed as prohibiting taxation of the preferred stock dividend, the decision of the Board of Tax Appeals affirming the Commissioner's determination of a deficiency should be sustained, because the gain from sale of the stock within the year was taxable income and the entire proceeds must be deemed income, since the stock had cost Gowran nothing. The Circuit Court of Appeals rejected that contention. It held that there was no income, because, as stipulated, there was no difference between the value of the stock when received

[1] Eisner *v.* Macomber was decided March 8, 1920. Soon thereafter, the Treasury Department declared, in a series of Decisions and Regulations, that no stock dividend was taxable. Treas. Dec. 3052, 3 C. B. 38 (August 4, 1920); Treas. Dec. 3059, 3 C. B. 38 (August 16, 1920); Office Dec. 732, 3 C. B. 39 (October 28, 1920). Office Dec. 801, 4 C. B. 24 (January 5, 1921) provided: "A stock dividend paid in true preferred stock is exempt from the tax the same as though the dividend were paid in common stock." Then followed legislation in the precise form embodied in § 115 (f) of the Revenue Act of 1928. See § 201 (d) of the Revenue Act of 1921, 42 Stat. 227, 228; § 201 (f) of the Revenue Act of 1924, 43 Stat. 253, 255; § 201 (f) of the Revenue Act of 1926, 44 Stat. 9, 11; §115 (f) of the Revenue Act of 1932, 47 Stat. 169, 204; § 115 (f) of the Revenue Act of 1934, 48 Stat. 680, 712. Article 628 of the Regulations in force in 1928 provided: "Stock dividends.—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in Articles 561 and 600."

Koshland *v.* Helvering, 298 U. S. 441, was decided May 18, 1936. On June 22, 1936, Congress, in enacting the Revenue Act of 1936, provided in § 115 (f): "1. General Rule—A distribution made by a corporation to its stockholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholders within the meaning of the Sixteenth Amendment to the Constitution." 49 Stat. 1648, 1688. See also § 115 (h).

and its value when sold. The court likened a non-taxable stock dividend to a tax-free gift or legacy and said: "One who receives a tax-free gift and later sells it, in the absence of statute providing otherwise, is taxed upon the profit arising from the difference in its value at the time he receives it and the sale price. Similarly one who receives a tax-free bequest, when selling it, is taxed upon the profit arising from any excess of the sale price over its fair market value at the time of receipt." Compare *Taft* v. *Bowers*, 278 U. S. 470.

The cases are not analogous. Unlike earlier legislation, Section 113 (a) (2) of the Revenue Act of 1928 prescribes specifically the basis for determining the gain on tax-free gifts and legacies. It provides that: "If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceeding owner by whom it was not acquired by gift." And the basis for the computation on property transmitted at death is provided for in paragraph (5). But the method of computing the income from the sale of stock dividends constitutionally taxable is not specifically provided for. Furthermore, unlike Section 22 (b) (3), excluding from gross income the value of gifts and legacies, Section 115 (f) cannot, in view of its history, be taken as a declaration of Congressional intent that the value of all stock dividends shall be immune from tax not only when received but also when converted into money or other property. Gain on them is, therefore, to be computed as provided in §§ 111 and 113, by the "excess of the amount realized" over "the cost of such property" to the taxpayer. As the cost of the preferred stock to Gowran was zero, the whole of the proceeds is taxable.

Gowran asserts that if this "basis of zero" theory is accepted, the proceeds are taxable not as determined by the Commissioner but as a capital gain at a different rate and under different regulations. This depends upon whether the preferred stock received as a dividend was a "capital asset", defined by Section 101 (c) (8) as "property held by the taxpayer for more than two years". The record is silent as to when Gowran acquired the common stock upon which the preferred was issued as a dividend, but it may be assumed that he had held it for more than two years. For that fact is immaterial since the dividend stock had been held for only three months. Whether taxed by Congress or not, it was income, substantially equivalent for income tax purposes to cash or property,

and under Section 115 (b) was presumed to have been made "out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits". In no sense, therefore, can it be said to have been "held" by Gowran prior to its declaration.[2] Since the proceeds were therefore not "capital gains", they were taxable at the normal and surtax rates applicable to ordinary income.[3]

Third. Gowran contends here that the Government should not have been permitted by the Court of Appeals to argue its "basis of zero" theory, because that theory raised an issue not pleaded, tried, argued or otherwise referred to in the proceedings before the Board. It is true that the theory was first presented by the Commissioner in the Court of Appeals. But it does not appear by the record that objection to the consideration of this theory was made below. The only objection made there, as disclosed by the opinion, was "that the Board was without jurisdiction to decide the case upon a point not urged by the commissioner." As to that objection, the court, after stating that the only questions submitted are those of law, said: "The Board approved the commissioner's assessment, but did so upon a legal theory different from his. We are of opinion that the Board acted within its powers. . . . It is immaterial whether the commissioner proceeded upon the wrong theory. The burden is upon the petitioner to show that the assessment is wrong upon any proper theory; otherwise he must fail."

In the review of judicial proceedings the rule is settled that if the decision below is correct, it must be affirmed, although the lower court relied upon a wrong ground or gave a wrong reason. *Frey & Son, Inc.* v. *Cudahy Packing Co.*, 256 U. S. 208; *United States* v. *American Ry. Exp. Co.*, 265 U. S. 425; *United States* v. *Holt State Bank*, 270 U. S. 49, 56; *Langnes* v. *Green*, 282 U. S. 531; *Stelos Co.* v. *Hosiery Motor-Mend Corp.*, 295 U. S. 237, 239; cf. *United States*

[2] Article 501 of Regulations 74 states that "if the taxpayer has held for more than two years stock upon which a stock dividend has been declared, both the original and dividend shares are considered to be capital assets". But this was based upon the erroneous premise that stock dividends could not be income, and was part of an administrative scheme to apportion some of the cost of the original shares to the stock received by way of dividend. This arrangement we declared in Koshland *v.* Helvering, 298 U. S. 441, to be without statutory authority, and the same must be said of the Regulation involved here.

[3] See Burnet *v.* Harmel, 287 U. S. 103, 105-106; Helvering *v.* New York Trust Co., 292 U. S. 455, 463; McFeely *v.* Commissioner, 296 U. S. 102, 106-107.

v. *Williams*, 278 U. S. 255. This applies also to the review of decisions of the Board of Tax Appeals. *Helvering* v. *Rankin*, 295 U. S. 123, 132-33; cf. *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206.[4] The taxpayer sought review of the Board's decision by the Court of Appeals. The ultimate question before that court was whether, upon the facts stipulated, the Board had erred in affirming the Commissioner's determination that the additional taxes were due. If the Commissioner was right in his determination, the Board properly affirmed it, even if the reasons which he had assigned were wrong.[5] And, likewise, if the Commissioner's determination was right, the Board's affirmance of it should have been sustained by the Court of Appeals, even if the Board gave a wrong reason for its action. By this rule the Government was entitled to urge in the Court of Appeals that on the undisputed facts the Board's decision was correct because of the "basis of zero" theory. And since that court rejected the theory, the Government was entitled to assert its contention here. Nothing in *General Utilities & Operating Co.* v. *Helvering, supra*, or in *Helvering* v. *Salvage*, 297 U. S. 106, is opposed to such procedure.

If the Court of Appeals had accepted the theory, it would have been open to the taxpayer to urge, in view of the new issue presented that he should have the opportunity to establish before the Board additional facts which would affect the result.[6] As we accept the new theory, leave is granted Gowran to apply to the lower court for that purpose.

Reversed.

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[4] See also Hurwitz *v.* Commissioner, 45 F. (2d) 780 (C. C. A. 2); Superheater Co. *v.* Commissioner, 38 F. (2d) 69 (C. C. A. 2); Commissioner *v.* Linderman, 84 F. (2d) 727 (C. C. A. 3); Dickey *v.* Burnet, 56 F. (2d) 917 (C. C. A. 8); Lewis-Hall Iron Works *v.* Blair, 23 F. (2d) 972 (App. D. C.); cf. Dobbins *v.* Commissioner, 31 F. (2d) 935 (C. C. A. 3); Seufert Bros. Co. *v.* Lucas, 44 F. (2d) 528 (C. C. A. 9); Hughes *v* Commissioner, 38 F. (2d) 755 (C. C. A. 10).

[5] Compare Darcy *v.* Commissioner, 66 F. (2d) 581 (C. C. A. 2); Helvering *v.* Gregory, 69 F. (2d) 809 (C. C. A. 2), aff'd, 293 U. S. 465; Alexander Sprunt & Son, Inc. *v.* Commissioner, 64 F. (2d) 424 (C. C. A. 4); Helvering *v.* Bowen, 85 F. (2d) 926 (C. C. A. 4); Atlanta Casket Co. *v.* Rose, 22 F. (2d) 800 (C. C. A. 5); J. & O. Altschul Tobacco Co. *v.* Commissioner, 42 F. (2d) 609 (C. C. A. 5); Crowell *v.* Commissioner, 62 F. (2d) 51 (C. C. A. 6); Schweitzer *v.* Commissioner, 75 F. (2d) 702 (C. C. A. 7), rev'd on other grounds, 296 U. S. 551; Christopher *v.* Burnet, 55 F. (2d) 527 (App. D. C.); Beaumont *v.* Helvering, 73 F. (2d) 110 (App. D. C.).

[6] Compare Woodward *v.* Boston Lasting Machine Co., 60 Fed. 283, 63 Fed. 609 (C. C. A. 1).